

AUDITOR DENUCCI, TREASURER CAHILL & EXPERT PANELS DISCUSS INVESTMENT POLICY AT PERAC'S CORPORATE GOVERNANCE FORUM



*Massachusetts State Auditor
A. Joseph DeNucci*

Massachusetts State Auditor A. Joseph DeNucci and Treasurer and Receiver-General Timothy Cahill spoke to public retirement board members, administrators, and investment professionals at PERAC's Corporate Governance and Public Investment Forum on June 15, 2004 at Holy Cross College in Worcester.

In his opening remarks, Auditor DeNucci, PERAC Vice Chairman, commended retirement board members for their fine work and emphasized their ongoing obligation to make prudent investment choices for the financial well being of the retirement systems' membership.

Treasurer Cahill provided insight into the decision-making processes at the Pension Reserves Investment Management (PRIM) Board, discussing steps taken to reallocate assets in order to more fully protect the Commonwealth's \$32B Pension Reserves Investment Trust (PRIT) fund from market fluctuations. He noted that, based upon the conclusions of an exhaustive analysis, PRIM would begin investing in hedge funds,

using a "fund-of-funds" approach. Treasurer Cahill described PRIM's process for selecting four managers to implement the hedge fund allocation strategy. The Treasurer also spoke about PRIM's decisive and timely response to Putnam Investments' implication in the market timing scandal. Putnam is no longer managing related funds for the board.

PERAC Executive Director Joseph E. Connarton explained it was a retirement board's fiduciary responsibility to adopt a rigorous corporate governance policy for its fund managers to implement and consultants to oversee. The goal of such a policy is to help boards ensure that corporations have sound governance practices before investing.

A panel of academic experts provided analysis of cases such as Enron, Tyco, and New Era Philanthropy. Professor W. Michael Hoffman, Executive Director of the Center for Business Ethics at Bentley College; Elizabeth K. Keating, Assistant Professor of Public Policy from the John F. Kennedy School of Government at Harvard University; and Paul M. Healy, James R. Williston Professor of Business Administration at the Harvard Business School offered practical steps retirement boards should consider when building their corporate governance policies. These included the need for retirement boards to continue practicing due diligence in investing, and to always maintain a long-term focus, remembering their mandate to create value for retirement. The speakers advocated pushing for more transparency in reporting and considering the ethical culture of a business as demonstrated by its operating practices.

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A second panel including Martin F. Healey, Assistant District Administrator, Enforcement, of the Boston District Office of the US Securities and Exchange Commission; Dr. John T. Por, President of Cortex; and Scott Harshbarger, Former Massachusetts Attorney General and Partner in the law firm of Murphy, Hesse, Toomey & Lehane, LLP discussed topics such as the SEC's enforcement initiatives, and internal governance policies that retirement boards can adopt to

ensure that they meet their fiduciary responsibilities.

Concluding the event was Matthew Nestor, Director of Securities and First Deputy Secretary of the Commonwealth. Mr. Nestor outlined Secretary of State William F. Galvin's aggressive efforts to address the securities violations of firms engaging in mutual fund market timing, and assured the audience that strong and vigilant enforcement would continue.



Massachusetts Treasurer and Receiver-General Timothy Cahill

FIRST HALF FINANCIAL MARKET SUMMARY

In sharp contrast to the volatility of the past several years, the major financial markets have all been essentially flat to only marginally positive during the first half of 2004.

Stocks have been in a narrow range as investors' enthusiasm over economic and job growth has been tempered by full stock valuations, concerns over Iraq and terrorism, and uncertainties over the future course of interest rates as well as the outcome of the presidential election.

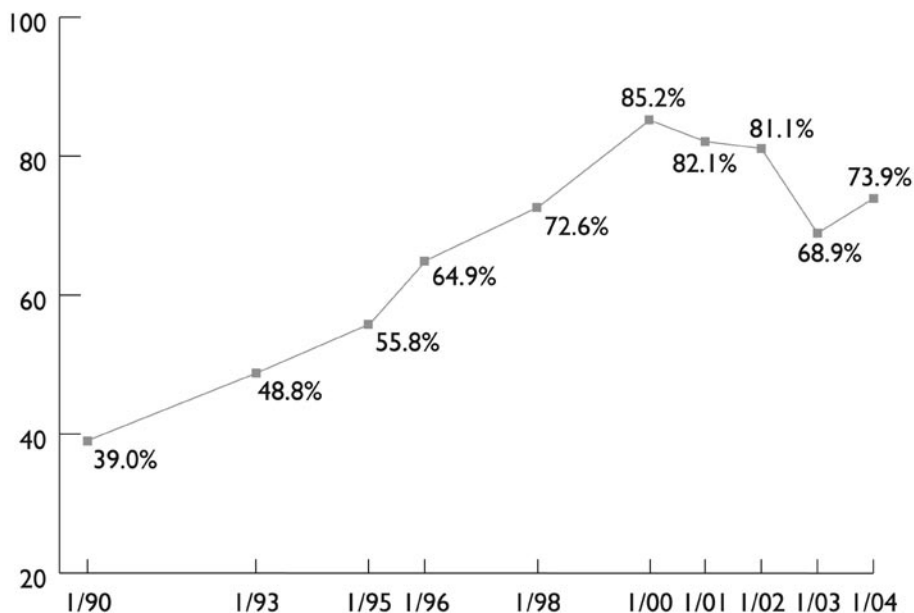
Small caps continued to outperform large caps but there has been little to choose between growth and value. On the whole, international stocks mirrored their US counterparts by being only moderately positive and searching for direction.

Bond returns were also meager as the level of coupon income was offset by the price declines caused by rising interest rates. Beginning with a much stronger than expected jobs report in early April and culminating with the Fed's first rate

increase in four years after 13 rounds of easing, the second quarter was among the worst for the bond market over the past ten years.

Real estate provided respectable positive returns and the venture capital market had a much-improved tone, but returns from these markets were insufficient to offset the doldrums in the two major asset classes.

COMMONWEALTH FUNDED RATIO



ACTUARIAL INSIGHT: THE COMMONWEALTH'S FUNDED RATIO PROGRESS

PERAC performs an actuarial valuation each year of the Commonwealth's pension system. The Commonwealth valuation measures liabilities and assets of the State Retirement System, the State Teachers' Retirement System, Boston Teachers and cost of living reimbursements paid by the State to local systems. The chart at left shows the Commonwealth's funded ratio progress since 1990. The funded ratio represents the actuarial value of plan assets divided by the actuarial accrued liability. When the funded ratio reaches 100%, a system is said to be "fully funded".

NEW SOCIAL SECURITY NOTICE RULE

All persons who are hired in a position that is not covered by Social Security on or after January 1, 2005 will be provided with a notice by the employer. The notice will advise the new employee of the impact of non-Social Security employ-

ment on the individual's Social Security benefit. A copy of the signed notice is to be sent to the applicable retirement board. It is the responsibility of the employer to provide the notice to the new employee and to the retirement board.

The board will be required to maintain a copy of the signed notice in the member's file. The Social Security Administration has not yet issued the notice form. We will update the boards when the notice is issued.

NEW MORTALITY TABLE TO BE DEVELOPED & ADOPTED

Sections of the Commonwealth's FY05 Budget direct the PERAC Actuary to develop a mortality table and select an interest rate to be used in determining the

"actuarial equivalent". The Commission has 180 days to review and select the new mortality table. The mortality table and the interest rate will be developed by the

Actuary and submitted to the Commission for adoption, to become effective on December 27, 2004.

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